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Supreme Court of the United States

October Term 1976

No. 76-1538

GRAYCO LAND ESCROW, LTD. and
HAWAIIAN RANCHOS, INC., dba
KBSF LAND CO., INC.,

Petitioners,

v.

GORDON Y.H. WONG, Director of
Taxation, State of Hawaii, and
STATE OF HAWAII,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF HAWAII

BRIEF FOR RESPONDENTS IN OPPOSITION

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TABLE OF CONTENTS

	Page
TABLE OF CONTENTS	i
OPINIONS BELOW	2
JURISDICTION	2
QUESTION PRESENTED	2
STATUTES INVOLVED	2
STATEMENT OF THE CASE	4
ARGUMENT	6
I. Grayco Is Doing Business In-State. The Receipts Were From Sources In-State	6
II. The Tax Is Not A Tax On Interstate Commerce	8
III. The Tax Does Not Burden Interstate Commerce	10
CONCLUSION	12

TABLE OF AUTHORITIES

Cases **Page**

J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938) 9

American Oil Co. v. Neill, 380 U.S. 451 (1965) 10

Central Greyhound Lines v. Mealey, 334 U.S. 653 (1948) 10

Cleveland, Painesville and Ashtabula R.R. Co. v. Pennsylvania, 82 U.S. (15 Wall.) 300 (1873) 10

Clifford v. State, 469 P.2d 549 (1970) 8

Complete Auto Transit Inc. v. Brady; decided in the United States Supreme Court March 7, 1977 11

Dahnke-Walker Co. v. Bondurant, 257 U.S. 282 (1921) 11

Department of Treasury v. Ingraham-Richardson Mfg. Co., 313 U.S. 252 (1941) 8

Department of Treasury v. Wood Preserving Corp., 313 U.S. 62 (1941) 9

Fisher's Blend Station v. Tax Commission of the State of Washington, 297 U.S. 650 (1936) 11

General Motors Corp. v. Washington, 377 U.S. 436 (1964) 10, 11

Gross Income Tax Division et al. v. Bartlett, 228 Ind. 505, 93 N.E. 2d 174 (1950), appeal dismissed 340 U.S. 925 (1951) 7,9,10

Gwin, White & Prince v. Henneford, 305 U.S. 434 (1939) 9

Page

Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123 (1931) 11

Hawaiian Beaches, Inc. v. Kondo 52 Haw. 279, 474 P.2d 538 (1970) 8,9

McCaw & Keating v. Tax Commissioner, Fase, 40 Haw. 121 (1953), aff'd. 216 F.2d 700, cert. denied, 348 U.S. 927 (1955) 11

McGoldrick v. Berwind-White Coal Mining Co., 309 U.S. 33 (1940) 9

New York ex rel. Whitney v. Graves, 299 U.S. 366 (1937) 9

Norfolk v. Western R. Co. v. Missouri Tax Commission, 390 U.S. 317 (1968) 10

Standard Pressed Steel Co. v. Department of Revenue of Washington, 419 U.S. 560 (1975) 11

Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938) 8

Wisconsin v. J.C. Penney & Co., 311 U.S. 435 (1940) 10

Statutes **Page**

§237-2 3,7
§237-3 3,7
§237-13 2,6,7
§237-13(10) 3,7

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OPINIONS BELOW

The opinion of the Supreme Court of the State of Hawaii is reported at 57 Haw. ___, 559 P.2d 264 (1977). The Findings of Fact and Conclusions of Law and the Judgment of the Tax Appeal Court of the State of Hawaii appear in the Appendix to the Petition at pages 4a and 20a.

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.

QUESTION PRESENTED

Whether the Hawaii Supreme Court's decision that Grayco Land Escrow, Ltd. (Grayco), a domiciliary of California, who has subdivided and sold its lands in Hawaii under agreements of sale, is engaged in business in Hawaii and subject to its general excise tax, measured by its interest income received from 1,179 agreements of sale, is in accord with applicable decisions of this court.

STATUTES INVOLVED

§237-13 *Imposition of tax.* There is hereby levied and shall be assessed and collected annually privilege taxes against persons on account of their business and other activities in the State measured by the application of rates against values of products, gross proceeds of sales, or gross

income, whichever is specified, as follows:

* * *

(10) Tax on other business. Upon every person engaging or continuing within the State in any business, trade, activity, occupation, or calling not included in the preceding paragraphs or any other provisions of this chapter, there is likewise hereby levied and shall be assessed and collected, a tax equal to four per cent of the gross income thereof. In addition, the rate prescribed by this paragraph shall apply to a business taxable under one or more of the preceding paragraphs or other provisions of this chapter, as to any gross income thereof not taxed thereunder as gross income or gross proceeds of sales or by taxing an equivalent value of products, unless specifically exempted.

§237-2 *"Business," "engaging" in business, defined.* "Business" as used in this chapter, includes all activities (personal, professional, or corporate), engaged in or caused to be engaged in with the object of gain or economic benefit either direct or indirect, but does not include casual sales.

The term "engaging" as used in this chapter with reference to engaging or continuing in business also includes the exercise of corporate or franchise powers.

§237-3 *"Gross income," "gross proceeds of sale," defined.* "Gross income" means the gross receipts, cash or accrued, of the taxpayer received as compensation for personal services and the gross receipts of the taxpayer derived from trade, business, commerce, or sales and the value proceeding or accruing from the sale of tangible personal property, or service, or both, and all receipts, actual or accrued as hereinafter provided, by reason of the

investment of the capital of the business engaged in, including interest, discount, rentals, royalties, fees, or other emoluments however designated and without any deductions on account of the cost of property sold, the cost of materials used, labor cost, taxes, royalties, interest, or discount paid or any other expenses whatsoever. . . .

* * *

The words "gross income" and "gross proceeds of sales" shall not be construed to include: gross receipts from the sale of bonds or other evidence of indebtedness or stocks or, except as otherwise provided, from the sale of land in fee simple, improved or unimproved, dividends as defined by chapter 235; cash discounts allowed and taken on sales; the proceeds of sale of goods, wares, or merchandise returned by customers when the sale price is refunded either in cash or by credit; or the sale price of any article accepted as part payment on any new article sold, if the full sale price of the new article is included in the "gross income" or "gross proceeds of sales." . . .

STATEMENT OF THE CASE

Petitioner Grayco, trustee and owner in fee simple of 4002.2916 acres of land situated at Kau, County and State of Hawaii, is a California corporation having its principal place of business at Pasadena, California. It is registered to do business in Hawaii, but it has no employees or place of business in-state.

These lands were conveyed undeveloped and in fee simple to Grayco, Trustee, by Hawaiian Ranchos, Inc. dba KBSF Land Co., Inc. (referred to as Hawaiian Ranchos in the Petition and KBSF herein) by Deed dated June 27, 1969

and recorded in the Hawaii Bureau of Conveyances in Liber 6604, Page 242.

Subsequently, the lands were subdivided into 1229 three-acre lots and the subdivision plans were recorded in the Hawaii Bureau of Conveyances; utilities were installed and streets and roads were laid out. The subdivision and improvements were in compliance with ordinances and regulations of the County of Hawaii.

R.J. Beaumont and Associates, a California corporation, whose principal place of business is Beverly Hills, California, was exclusive real estate broker in the sale of Grayco's Hawaii property. Advertisements offering the lots for sale were made through newspapers, radio and television in Hawaii and California and through the United States mail.

Beaumont engaged subagents, who were licensed Hawaii real estate salesmen, to contact prospective purchasers in Hawaii.

When a lot is sold, Grayco, as vendor, and the vendee execute a standard form agreement of sale, which provides for installment payment of the purchase price, including interest on the unpaid principal balance. When all installments are received by Grayco in Pasadena, Grayco issues a deed, mails it to the Hawaii Bureau of Conveyances for recordation and thereafter mails the purchaser a copy. If the purchaser requests title insurance, the deed is sent to Title Guaranty of Hawaii for processing. Of the 1229 lots, 1179 were sold by Grayco on agreements of sale.

The installment moneys received by Grayco are disbursed to beneficiaries, who are all parties to and pursuant to an unrecorded trust agreement, known as Subdivision Agreement No. 152, dated June 24, 1969, which was entered into by Commonwealth United

Corporation, KBSF and Grayco; it was subsequently amended to add Beaumont and again amended to include Dow Banking Corporation.

Commonwealth United Corporation financed the purchase of the land and initial subdivision improvements and held a mortgage on the property. Exeter Equities, a Massachusetts limited partnership, and Dow Banking Corporation, a Swiss corporation, subsequently also advanced funds for the purchase or subdivision improvements.

Purchasers in California were offered an "Aloha Bonus Plan" which gave a $400 credit to each vendee traveling to Hawaii to view the lot with a sales subagent of Beaumont as guide.

The Director of Taxation, State of Hawaii, assessed Grayco gross receipts taxes, penalties and interest on the interest income received from these agreements of sale.

The Tax Appeal Court of the State of Hawaii found that Grayco is engaged in business in Hawaii, that Grayco was not engaged in interstate commerce and, even if interstate commerce were involved, the assessment measured by interest income derived from agreements of sale of land situated in Hawaii was valid. The Hawaii Supreme Court affirmed.

ARGUMENT

I. Grayco Is Doing Business In-State. The Receipts Were From Sources In-State.

A privilege tax is imposed by the State of Hawaii on all persons doing business and other activities in the State. §237-13, Hawaii Revised Statutes.

All businesses in-state, even if the businesses are not enumerated in the statute, are subject to the tax. §237-13(10), Hawaii Revised Statutes.

"Business" is defined in the general excise tax law to mean all activities engaged in for gain or economic benefit either direct or indirect, except casual sales. §237-2, Hawaii Revised Statutes.

The tax is measured by applying rates against values of property, gross proceeds of sales or gross income. §237-13, Hawaii Revised Statutes. "Gross income" is defined to include "all receipts . . . by reason of the investment of the capital of the business engaged in, including interest. . . ." §237-3, Hawaii Revised Statutes.

The argument that the Hawaii Supreme Court characterized interstate financing as in-state in nature through distortion of facts and creating a fiction is without basis. There is no distortion of facts or fiction. Grayco subdivided 4002.2916 acres of its lands in Hawaii into 1229 lots and sold all of them; 1179 were sold in installments under agreements of sale. The Tax Appeal Court and Hawaii Supreme Court found that the interest income was derived from installment contracts of the sale of land in Hawaii. It was therefore from sources within the state and taxable.

Indiana has jurisdiction to impose its gross receipts tax on principal and interest income received by a nonresident under installment sales contracts for Indiana property notwithstanding taxpayer's argument that the taxable situs of the contracts of sale was outside Indiana. *Gross Income Tax Division et al. v. Bartlett*, 228 Ind. 505, 93 N.E.2d 174 (1950), appeal dismissed 340 U.S. 925 (1951). The court held that receipt of income from the sale of lots within the state was derived from sources within the state.

In an earlier decision, the Hawaii Supreme Court held that interest income of a domiciliary from installment sales of land situated in Hawaii is taxable business activity notwithstanding the contracts were executed out-of-state and payments of installments were made out-of-state. *Hawaiian Beaches, Inc. v. Kondo,* 52 Haw. 279, 474 P.2d 538 (1970). The court held that, under the statute, the selling price is exempt, but the interest income from agreements of sale of Hawaii property is taxable.

Petitioner's argument that *Hawaiian Beaches, Inc. v. Kondo, supra,* held interest income comes from the activity of lending money is without basis. The Hawaii Supreme Court refuted this interpretation. Appendix to Petition, page 21a.

Interest income received from installment sales of real estate was taxable as a part of the gross income of the "business of subdividing and selling real estate." The selling price under the Washington statute was exempt from the tax. *Clifford v. State,* 469 P.2d 549 (1970). The court found there is a distinction between a loan based on advancement of money and relinquishing the right to immediate payment.

II. The Tax Is Not A Tax On Interstate Commerce.

The lands owned by Grayco are located in Hawaii and the sources of the income are in Hawaii.

The contracts between citizens of different states are not in interstate commerce where the performance of the contract is to be completed and carried out wholly within the borders of the state. *Western Live Stock v. Bureau of Revenue,* 303 U.S. 250 (1938); *Department of Treasury v. Ingraham-Richardson Mfg. Co.,* 313 U.S. 252 (1941);

Department of Treasury v. Wood Preserving Corp., 313 U.S. 62 (1941); *Gross Income Tax Division v. Bartlett, supra.*

Proceeds of sale of a membership in the New York Stock Exchange by a nonresident were subject to taxation by New York State on the ground that the right to conduct transactions at the exchange and its very nature localizes it at the exchange. *New York ex rel. Whitney v. Graves,* 299 U.S. 366 (1937).

Domiciliaries of the State are subject to the same tax. The tax is nondiscriminatory. *McGoldrick v. Berwind-White Coal Mining Co.,* 309 U.S. 33 (1940).

J.D. Adams Mfg. Co. v. Storen, 304 U.S. 307 (1938), wherein the gross receipts tax based on sales in other states was invalidated on commerce clause grounds, is distinguishable. Movable goods manufactured in Indiana were involved there as distinguished from the present case in which the property has a permanent situs in Hawaii. This court significantly held in *J.D. Adams Mfg. Co. v. Storen, supra,* that, if the tax is on the "privilege" of doing local business measured by gross sales, the measurement of the tax can include interstate as well as local sales assuming there is some local business.

Gwin, White & Prince v. Henneford, 305 U.S. 434 (1939), is also distinguishable. Fruits were shipped from Washington State and were moving in commerce between the states; in our case the land is situated in Hawaii permanently. It was recognized in *Gwin, supra,* that even interstate commerce must pay its way and that not every local tax measured upon gross income from interstate commerce is forbidden. In the present case local business must also pay the same tax on its interest income from deferred payments on sales of land. *Hawaiian Beaches, Inc.*

v. Kondo, supra. There is no discrimination against foreign corporations.

Norfolk v. Western R. Co. v. Missouri Tax Commission, 390 U.S. 317 (1968), and *Central Greyhound Lines v. Mealey,* 334 U.S. 653 (1948), are not applicable because the taxpayers were transportation companies as compared with in-state activity of selling land located in-state.

American Oil Co. v. Neill, 380 U.S. 451 (1965), is also inapplicable. The sale of motor fuel was there made out-of-state after which it arrived in-state.

The case of *Cleveland, Painesville and Ashtabula R.R. Co. v. Pennsylvania,* 82 U.S. (15 Wall.) 300 (1873), is inapplicable because bonds of the corporation owned by nonresidents were involved. In the present case, the activity is the owning, subdividing and selling lands in Hawaii under installment sales contracts. There is a distinction between the two transactions.

III. The Tax Does Not Burden Interstate Commerce.

Petitioner has not shown in what manner interestate commerce is burdened. Since the tax is on contracts of sale of land within the State, there is no possibility of a similar tax on the same transaction by another state. *Gross Income Tax Division v. Bartlett, supra.*

The Tax Appeal Court and Hawaii Supreme Court found that the Petitioner received local benefits such as the privilege of operating a business, and the use of roads, streets, laws, ordinances, recording system and the courts in the conduct of its business. *Wisconsin v. J.C. Penney & Co.*, 311 U.S. 435 (1940); *General Motors Corp. v. Washington*, 377 U.S. 436 (1964).

The tax on unapportioned gross receipts was sustained if the State has exerted its power in proportion to the taxpayer's activities within the State and to its consequent enjoyment of the opportunities and protections which the State has afforded. *General Motors Corp. v. Washington, supra*; *Standard Pressed Steel Co. v. Department of Revenue of Washington*, 419 U.S. 560 (1975).

Radio broadcasting within the state was held sufficient in-state activity to sustain the tax. *McCaw & Keating v. Tax Commissioner, Fase*, 40 Haw. 121 (1953), aff'd. 216 F.2d 700, cert. denied, 348 U.S. 927 (1955).

Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell, 283 U.S. 123 (1931), involved apportionment formulas of a foreign corporation whose sources of income were derived from different states. The case is inapplicable here, because the source of Grayco's income is the land located in Hawaii.

Grain sold and moving in interstate commerce was involved in *Dahnke-Walker Co. v. Bondurant*, 257 U.S. 282 (1921). Under recent cases, even interstate commerce must pay its way. *Complete Auto Transit Inc. v. Brady*, decided in the United States Supreme Court March 7, 1977.

The holding in *Fisher's Blend Station v. Tax Commission of the State of Washington,* 297 U.S. 650 (1936) that radio broadcasting is interstate commerce is not applicable here where the income is from lands in Hawaii which are sources within the State of Hawaii.

CONCLUSION

For the reasons stated above, Respondents request that a Petition for a Writ of Certiorari should be denied.

Dated: Honolulu, Hawaii, June 3, 1977.

Respectfully submitted,

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I hereby certify that a copy of this Brief In Opposition was served upon John P. Gilmor, Attorney for Petitioners, by mailing the same to him at his office at 1100 First Hawaiian Bank Bldg., Honolulu, Hawaii 96813 this date.

Honolulu, Hawaii, June 3, 1977.

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